RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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APRIL 17, 1985 LETTER 911

April 4 DJIA 1259.05; PTI 1695; A-D Ratio -16.93
April 12 DJIA 1265.68; PTI 1720; A-D Ratio -16.56

THE PICTURE: So far, despite much frustration, it really has been a pretty good year for Wall Street. Here are the figures for the first quarter ending March 31: DJIA up 4.6%, DJTA up 8.1%, DJUA up 2.3%, S&P 500 up 8.0%, Value Line Composite up 9.3%, Amex Market Value Index up 12.4%.

In all the years I've been in this business, I've never seen so much emphasis on trading and beating the market. And, of course, every week seems to bring news of some new option, warrant, future contract or trading vehicle. With this much emphasis and energy concentrating on trading and timing, I predict that the traders are going to have a very hard time of it during 1985. The reason? When everybody concentrates on a single area of Wall Street, the market finds a way to cross them up. You may not want to hear this, but the market doesn't like winners -- and that's why there are so darn few winners on Wall Street. Many, many years ago, when I first started out in this business, an old-time trader told me, "Russell, the market is a wild animal, and it's out to kill you!" "Yeah," I answered, "and it's been doing a pretty good job of it so far."

One of the biggest market winners of the past 20 years is Warren Buffet, who I've mentioned many times. Buffet owns 45% of Berkshire Hathaway, and he's worth about $850 million. It was Buffet who put up the huge chunk of capital ($518 million) which allowed Capital Cities to take over ABC. When asked why he veered from his usual investing philosophy and why he put up so much of his capital in a single venture, Buffet stated that it was becoming increasingly difficult to find the kind of bargains he likes on Wall Street. Everybody is playing the Ben Graham bargain game, he explained, and for this reason he varied from his usual investing procedure and bought the mighty chunk of Capital Cities Communications.

So we have a market that is worked over by the technicians and worked over by the value-oriented bargain hunters. So what's left? It could be a period of frustration within a trading range. And who does the trading range favor? Only one group. The patient compounders, the investors who collect the dividends, put those dividends together with whatever spare cash and savings they have, and buy more stock or notes or bonds, thus upping their total income still further.

For a couple of years, I've been writing that this is a market with the highest real interest rates in modern history, and thus it is a market ready made for compounders. I stick by that statement. And I invest that way myself.

In the last Letter, I stated that the Averages (and they don't always do this) have given us a gift. The gift is nearby points, significant points, points that we must watch closely. On the upside we have the March 1 record highs of 1299.36 for the D-J Industrials, 635.30 for the Transports. A joint bettering of those points would obviously represent an "all-clear" signal.

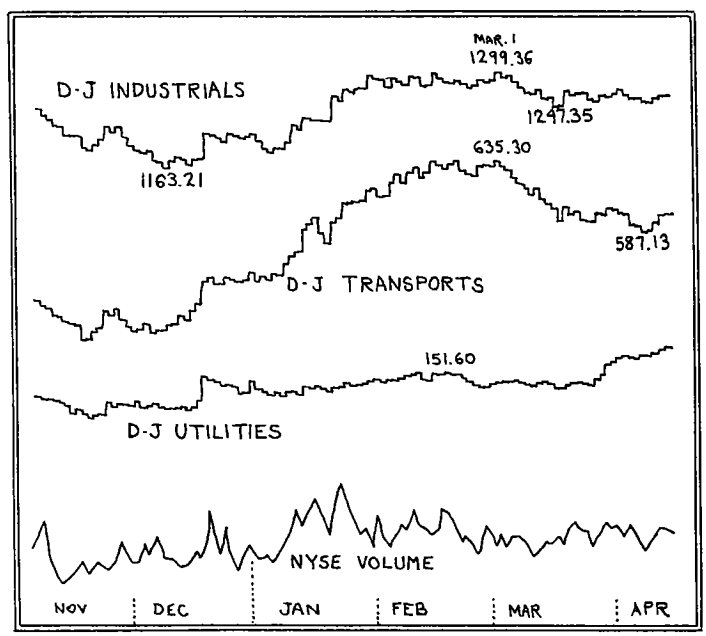
On the downside we now have the 1247.35 mid-March low for Industrials and the April low of 587.13 for the Transports. If you study the page 1 chart you will note that the Transports broke below their March lows on their way to 587.13, but the Industrial Average refused to confirm. That downside non-confirmation set off a rally, but how powerful the rally is remains to be seen.

Here are a few notes on the market action so far: (1) Both IBM and GM have been laggards on this rally, both having broken down technically. The market can advance without these two bellwether issues -- but it's not easy.

(2) Much of the upside action in the stock market seems to be geared to the rallying bond market. But declining interest rates alone cannot make a bull market. A bull market is a reflection of rising corporate profits.

(3) The odd lot ratios indicate that the public is growing progressively more optimistic as this market rises. I consider this a negative.

(4) Technically, the strongest points FOR the stock market are (a) The new highs in the D-J Utility Average, (b) the five-week high in the NYSE Financial



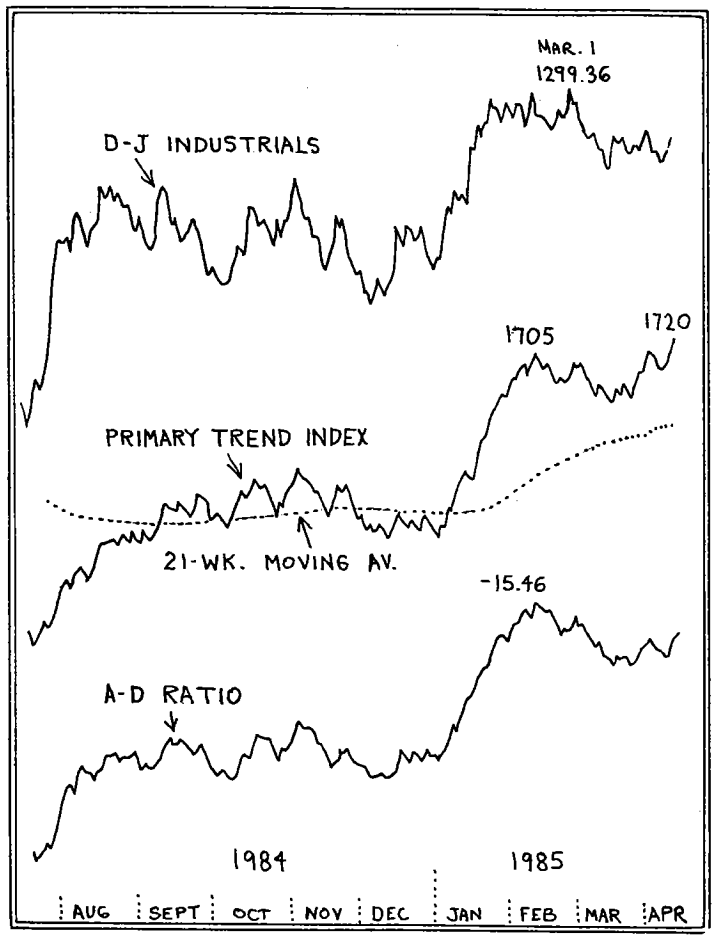
Index, (c) the dearth of new 52-week lows on the NYSE, even on days when the market declines.

(5) My PTI (page 2 chart) has pushed to new highs, again without confirmation by the D-J Industrials. In fact, the Dow isn't even close to confirming, and that bothers me. Why are the Averages so RELUCTANT to follow the PTI? In the past when this has happened it has spelled trouble.

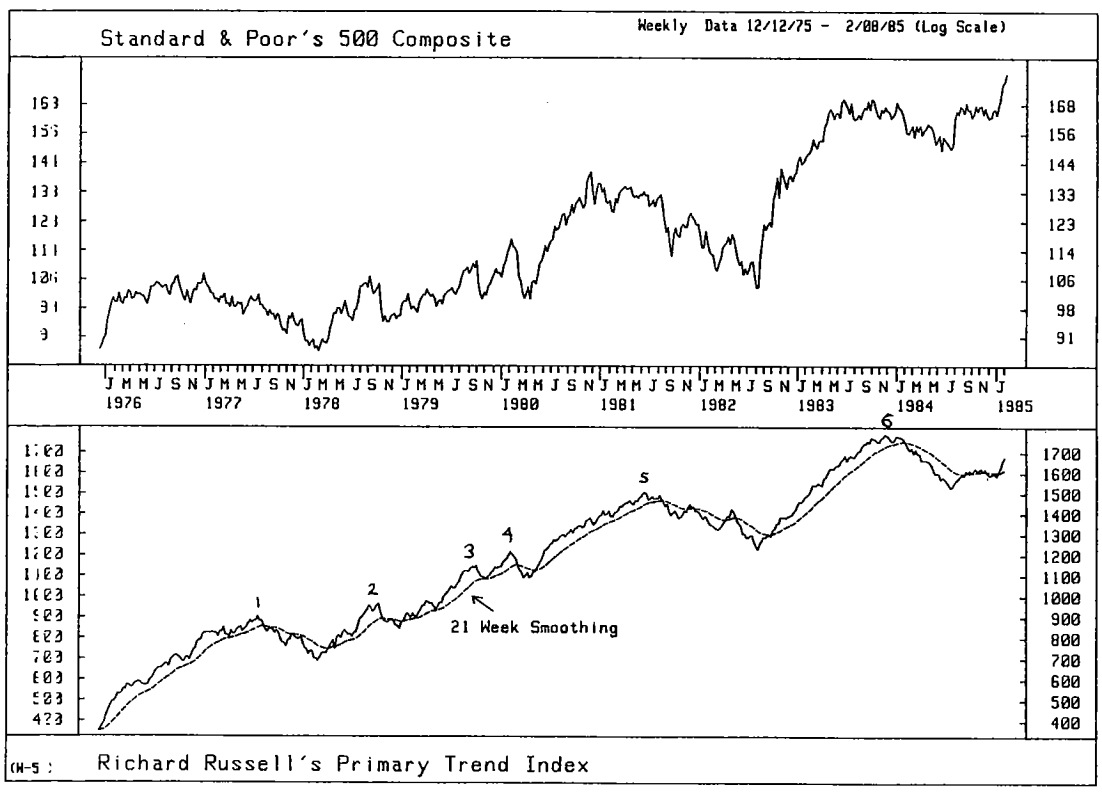
PTI PERSPECTIVE: For the benefit of new subscribers I should explain that my Primary Trend Index is an amalgam of eight indicators, each indicator based on ACTION of the market (as opposed to sentiment indicators, odd lots, short sales, etc.). I developed the PTI in the late 1960's and early '70's for the purpose of aiding me in identifying the major or primary trend of the market. The PTI is actually a technical "balance" which by its nature must go up when the primary trend of the market is up, and conversely, it must go down when the primary trend is down.

The catch, of course, is that primary action is not always identifiable. There are times when the various averages, indices and advance-decline lines are so stagnant or confused that the primary trend seems to be "hanging in mid-air". The period from late-August of 1984 to the present is one of these periods.

Ned Davis Research has run off this long-term chart of the PTI and the S&P 500 Composite. The chart covers a decade of action. Whether you follow the PTI on a trendline basis or in relation to its own 21-week moving average, I think you can see that the PTI is a valuable instrument. There are periods such as during 1976 and most of 1977 when the action of the PTI was absolutely clear (and bullish). Again during 1980 and first-half of '81 and during mid-1982 and most of '83 the PTI was undeniably bullish. Conversely, the period of late-1977 and mid-1981 to mid-1982 was bearish.



As you can see, the PTI moved sideways, literally straddling its 21-week moving average, from the period of August to January 1985. During January and February the PTI roared up to a recovery high of 1705 on February 13. It then backed off, only to advance to another new high of 1714 on April 11.



Now here is an interesting observation and one that has me a bit worried. Note on the chart that since 1976 the PTI has been advancing to successive new peaks along with each major peak in the Dow. These peaks are marked on the chart.

But now, for the first time, the PTI has failed to confirm a new high in the Dow. At the March 1 Dow high of 1299.36 the PTI was far short of its 1984 peak (at #6 on the chart). Thus, there is something new in the picture. Is the PTI telling us that the Dow action in 1985 is just a cover-up, a temporary show of strength in a basically weak market?

The picture then, is that of the Dow advancing to a new record high on March 1, 1985. That high was not confirmed by the PTI. Then, after a decline, the PTI rose on April 1st to a new 1985 high (a high below the 1984 peak). But here it was the Dow that failed to confirm (see chart, page 2).

This presents a technical picture that I have not seen before. Namely, we have a record high in the Dow unconfirmed by the PTI, followed by a secondary high in the PTI unconfirmed by the Dow. What does this double non-confirmation mean?

I would say that the current Dow/PTI relationship implies basic weakness. I will change my mind on this ONLY if the Dow gathers up enough strength to advance to a new high above its record 1299.36--thus confirming the recent PTI action.

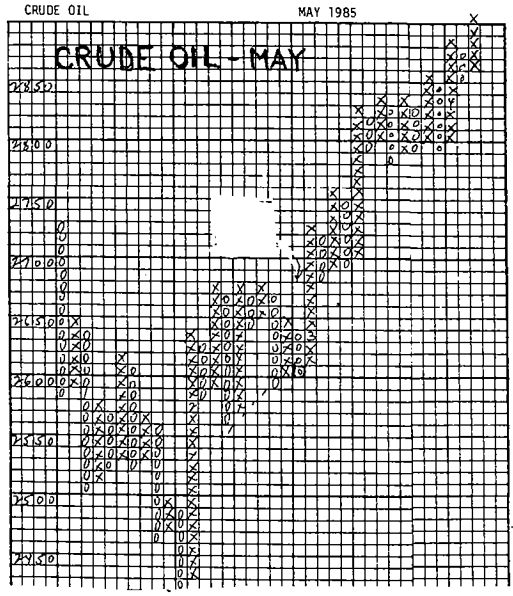
INVESTMENT POSITION: The nervous bull is still in the box. My PTI keeps advancing to new highs (see page 2 chart), but the Dow is laboring, laboring. Maybe it's unhappy about lagging GM and IBM, I dunno. At any rate, I'd feel a lot better if the Dow confirmed by rallying above 1299.36. So far, the PTI and the Utility Averages are the heroes of this advance, and that'll have to do, at least for now. As I've said so many times in the past, they don't arrange the market for Richard Russell's comfort.

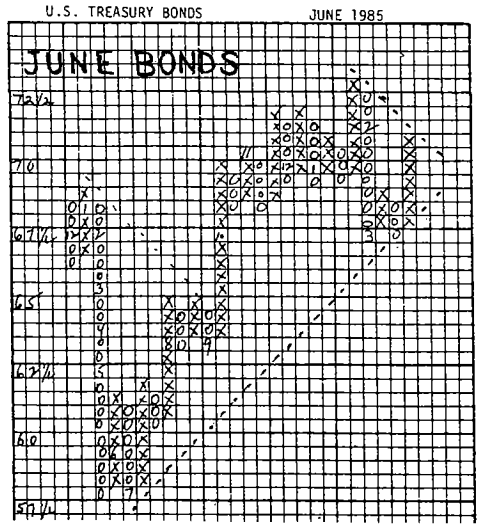
If you haven't bought stocks by now, I don't know what to tell you. We received our buy signal from the PTI in early January, and it now seems late to jump in on the action. In the market, "better late than never" is usually a costly procedure. So those of us who have already bought stocks should sit it out. I'm still holding my bonds (mostly munis), and at the risk of being wrong I haven't bought gold yet (see gold section).

WHAT'S HAPPENING? In the foreign currencies, the June British pound rose above 1.24 to a new recovery high on April 11. Yes, the lowly pound has been the glamour foreign currency leader against the dollar, and those who bought pounds at the bottom (see Letters 908 and 909) should now be eating filet or perhaps Beluga caviar. By April 12 the New York Times was quoting the chief corporate traders of Credit Lyonaise as saying, "Nobody's got a good thing to say about the dollar these days. It's the same psychology as the euphoria that was built up to make the dollar invincible."

The identical story goes for crude oil. This chart (courtesy Chartcraft) shows the major rise in the May oil contract. The entire rise took place in the face of widespread dire predictions that oil was going to sell for "$25 down to $20 a barrel by late 1985. "If you believed that and went short, you're probably talking to your banker about an emergency loan.

On the other hand, the T-bonds are a tough case. The June contract appeared to top out at 73 (at least I thought it did). It then plunged to 67.5, a drop you can see on the chart. Since then the June contract has



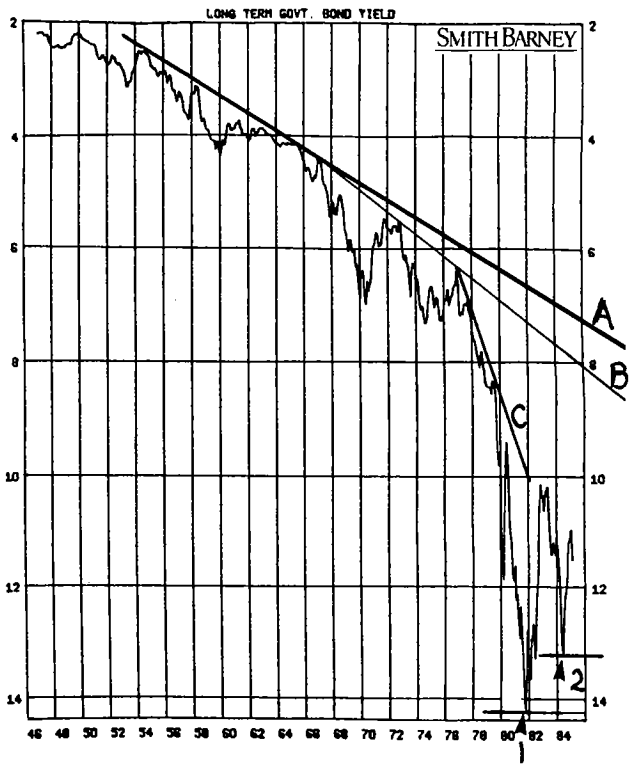


risen to 71. It remains to be seen whether the June contract can advance above the 73 high again. Bonds have been strong on signs of a declining US economy (less activity, less need for new financing in the money markets). But if the economy is slowing down, then tax receipts to Uncle Sam are also going to drop off. And that means MORE financing by the Treasury. But the bond market is not thinking that far ahead--YET.

Meanwhile, the T-bill contracts have rallied to new highs (unconfirmed by the bonds). Let's watch to see whether this non-confirmation stands. On major moves, the T-bonds and T-bills should confirm each other.

PERSPECTIVE: If you are on the edge of the jungle and you want some perspective on where you are, you would probably climb a tall tree and look out over the treetops for as far as the eye could see. If you want perspective on the bond market, you draw a chart that "steps back" and traces the bond action for as far as the eye can see.

This chart of long-term Treasury bond yield does just that. The chart goes back almost 40 years to 1946. And what we see is a yield line that follows a downward course (holding below trendline "A") ever since 1946. In 1946, would you believe it, the T-bonds provided a yield of just over 2%.



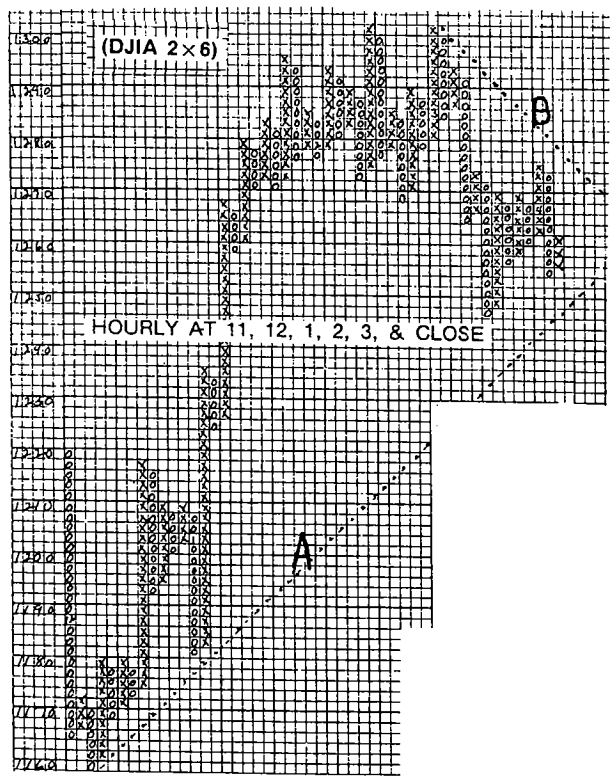
Around 1966 the yield trendline grew steeper, and this is shown by Trendline "B". Finally, in 1977, Trendline "C" denoted an almost panic level of rise in T-Bond yields, culminating in the 15% rates of 1982.

The first climactic explosion in rates (to near 15%) occurred at arrow #1. The second explosion (of lesser force) occurred at arrow #2. The rate on the long bonds are currently in the 11% to 12% range, still far below primary trendlines A and B.

Question, what happens next? If the bear market is over for bonds, I would still be looking for a "three strikes and you're out" situation. This is a usual way that a big bear market ends. If that happens, we might expect one more explosion taking interest rates to say 12.5% on the bonds. In the event of a total breakdown on the budget, we can expect the lows at #1 to be tested again.

From the optimist's standpoint, we would want to see a yield drop that would take the line through the 10% level, thereby characterizing all the bond action since 1980 as a huge bottom.

One thought: the spread between T-bill yields and long-term bond yields is about 3.9%, a whopping large spread. This big spread reflects the long-term bond market's fear of inflation (or could it be repudiation?). Let's look at it this way. At 3.9% money DOUBLES in 19 years (19 years is the length of a typical long-term bond maturity). So that 3.9% represents a huge sacrifice in yield for the bill owner (the man who buys bills instead of bonds). Yet that 3.9% spread in favor of bonds is the market's way of saying, "I'll play it safe in short-term money, even if it costs me a fortune over the next twenty years." Why are long-term bond buyers so pessimistic? Ah, that's what worries me (but if you look at Congress you may have the answer to the bond market's pessimism).



DOW: Here is a point & figure chart (courtesy Chartcraft) that should help clarify the current situation. The chart is a 2 x 6 analysis, which means that each box on the chart is worth 2 Dow points and only rallies and declines of 6 points or more are shown. The X's denote advances, the O's denote declines.

The Dow is now "suspended" between the major bullish trendline marked A on the chart and the secondary bearish trendline marked B on the chart. The most recent P & F signal was a bearish signal, occurring when the Dow touched the 1258 box. Since then we have seen a feeble Dow rally to the mid 1260's.

A new and fairly strong bullish signal would occur if the Dow hit 1278 on an hourly basis. At over 1280, the Dow would better the bearish trendline B.

A new bearish signal would occur on an hourly reading of 1254, and at 1246 we would have a very bearish Dow signal. At 1246 the Dow would break below its last low box at 1246, and it would also drop below the rising trendline A.

NOTES & QUOTES: A few months ago I wrote that the great vacuum in Soviet plans for being numero uno in the world was--their fear of making computers available to the average Russian. Why the fear? Computer access to information. But Mr. Gorbachev has obviously decided that to compete with the West, Russians must master computers. Last week it was announced that the Russians are getting ready to order large numbers of computers from the West. This is from the April 4 New York Times:

> **Last week, the ruling Politburo directed the Soviet Union's 60,000 high schools to begin training in computer science. Meanwhile, Soviet trade officials have stepped up efforts to purchase thousands of microcomputers, from the least powerful home models to advanced new machines.**

Deals Are Believed Near

Industry sources indicate that the first deals appear only months away. They are likely to involve Apple Computer Inc., the Cupertino, Calif. company that makes the popular Apple II line of machines, and Sinclair Research Ltd., a British manufacturer of home computers now negotiating with the Soviet Ministry of Education.

Commodore International Ltd., the leading American maker of home computers, said it expected to begin serious negotiations in the next month.

Sports: By the end of this season the USFL football league will have lost a total of $150 million. The league's future is therefore very "iffy". By 1986 the NFL will also be in the losing column as average NFL player's salaries rise to $200,000 a year. Over the past year five NFL teams will have been sold (only four of the original USFL teams still have their original owners). Now baseball announces that 18 of the league's teams lost a combined $66 million last year. Professional sports teams are now for ego, not for profit.

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Statistics: Since the 1978 deregulation rules, 50 airlines have gone belly up. And rates have come down, way down....Merrill Lynch now has more brokers selling real estate than they do selling corporate securities.

You want to grow old? Nations with the longest average life span, (1) Iceland at age 77, (2) Netherlands at 76, (3) Sweden at 76, (4) Norway at 76, (5) Japan at 76. You want to die young. Here are the worst life spans (1) Ethiopia worst at 40 along with Chad and Afghanistan, (2) next at 42 are Gambia, Guinea-bissau, Burundi and Angola. Conclusion: Stay out of Africa if you want to grow old and move to the cold climates.

Automotive Industries surveyed 1,132 manufacturing and production managers in the auto industry and came up with the following: fewest number of manufacturing defects were in Mercedes. Then in descending order were GM, Ford, Toyota and Honda. Poor in quality (are you ready for this?) were BMW and Porsche.

Living alone: Single adult households in 1950 were 9% of the total. In 1983 they rose to 23% of the total. People are living alone more and liking it more.

Man has eliminated or moved to the point of extinction the following animals: passenger pigeon, sea mink, Eastern buffalo, plains buffalo, wolverine, loon, California Condor, certain species of whales. Despite traps, guns, poisons, only the wily coyote has managed to actually increase (125,000 coyotes are killed in the US every year).

Where's the beef in retail sales? Following are the top states in sales increases, 1977 to '82: Texas with 80% increase, Florida 77%, Alaska 76%, Nevada 74%, Oklahama, 74%, Arizona 71%, Wyoming 71%, Colorado 69%.

* *

On the Larry King show Steven Birnbaum, nationally syndicated travel writer, was asked where, if he had to retire, he would live. His choices: Rancho Santa Fe (just north of San Diego) or Sarasota, Florida.

* *

Writing in the April 3 New York Times, famed author Alan Paton (he wrote "Cry the Beloved Country") has this to say to the liberals who want to pull all US corporations out of South Africa:

I have a word to say to those Americans who think they can hasten the "day of liberation" by damaging the South African economy, as for example, by disinvestment. I do not think that damaging our economy will help us to do better. It will do material harm to many black people. Americans ought to be told that they are going to bring hunger and suffering to many black people. One often hears black South Africans cry: "We don't mind suffering. We are used to it." But this cry usually comes from those articulate blacks who will suffer least. I, as a Christian, will have nothing to do with disinvestment. To believe that disinvestment will bring our Government "to its knees" is to believe nonsense.

What would happen if the West withdrew from us completely? (Except for trade in a few strategic minerals, of course.) What would happen if the West left South Africa in a vacuum? Who would fill the vacuum? Readers can have one guess.

*

I do a lot of reading, and I guess I've lost track of the number of magazines, newspapers, books and clips (sent by subscribers) that I go through in a day. One advantage of this is that you start to put things together, you get stories and scenarios out of all this information.

And one story that is becoming patently clear is that China is coming on as the major potential market of the world. Japan is already China's biggest trading partner. And Russia has been making loud noises in favor of closer ties to China.

Here's a clip from last week's Variety (the bible of showbusiness). I thought it was significant:

The boxoffice potential of a nation with a population of more than a billion would be staggering, but in the case of the People's Republic of China, there is no correlation between boxoffice and film rental.

Yet, while the cash registers have barely started ringing, the first signs of a potentially lucrative film market in China may have started to surface.

The China Export & Import Corp. has established a permanent headquarters in Los Angeles, and representatives are attending their first American Film Market prepared to acquire films for Chinese theaters.

Picked up from Cannon International were "Breakin'" and "Body And Soul." A deal was also made with Crown International for "Police Women."

Entertainment Sought

Kuang indicated that the criteria for selecting films was only that they be entertaining without an excess of sex. Lu added that action films probably translate the best, with comedies the most difficult for Chinese audiences to appreciate because of the vast cultural differences.

The Chinese have purchased "La Traviata" and "Misunderstood" from PSO and "First Blood" from Carolco, although it hasn't played yet. Also picked up last year were two 3-D pix, "Treasure Of The Four Crowns" from Cannon and "Comin' At Ya" from Jad Films International.

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The rumor is that Rona Barrett, having retired after being burned out via the "Today" show and "Good Morning America," is now returning. One project she is doing is a freebie for cassette retailers entitled, "Coming Attractions". This will be a review handout but it will emphasize gossip regarding who's making how much and who is paying whom. Sex is out in Hollywood and money is in.

Have you noticed that even the sports pages now read like the financial pages with top billing given to what athlete gets how much from whom and for how long? The whole country is becoming "yuppie" oriented, which brings to mind the Oscar Wilde adage: "A cynic is a person who knows the cost of everything and the value of nothing." It can't happen here - but it is. American Babylon.

FECUNDITY: With thousands (some say millions) starving across the face of Africa, it is ironic that Africa also has the highest birth rate in the world (in Ghana half the population is under 15). But the US is hardly setting any high-morality standards. The latest figures show that almost 10% of all teenage girls are getting pregnant (ages 15 to 19), and most of them aren't married. We are in danger of becoming a nation of child-mothers (so you can imagine which way the welfare statistics are going).

With it all, large pressure groups actively campaign against birth control and sex information in the schools. With four daughters of my own, I feel I have something to say about it. The sex urge is there, TV and movies promote it, and the prohibitions against sex (which existed when I was a boy) literally don't exist today. Those are facts. Thus we are left with sex education and birth control. To be against those two items, in my opinion, is madness. What are the alternatives to sex education and birth control? Abortion clinics, welfare and kids who have no idea who their fathers are.

* *

My good friend, Eliot Janeway, was writing about economics when most readers of these letters were kicking the slats out of the cradles. I just finished reading the latest Janeway Letter (15 E. 80th St., NYC 10021), and I can tell you that Mr. J. is not happy about the way things are going. Here's the opening paragraph: "The confusion admitted in the market is deepening into worry about a recession: the wrong danger. We should be so lucky. Recessions are self-curing because they invite paydowns of debt. There is an uglier word -- depression! -- for today's trouble because it's building up debt as it chokes off income."

* *

Readers may be happy to hear that I have sold my big Honda motorcycle, and I have now decided to either walk to where I am going, fly (in a plane) or take a car. I've ridden cycles for 25 years, and (sob) I figure it's time to stop. The nearest I can get to that cycle feel is in my 1965 Jaguar convertible.

GOLD: We may be in for monster inflation, but I don't see it yet. The only big inflation I see is the inflation in the total amount of US debt plus the inflation in the number of financial institutions now going belly up. The Fed has been pumping up the money supply in an effort to "float the nation's banking and thrift back into solvency," and I guess you could call that a kind of inflation. But it certainly isn't the classical variety.

Gold has risen from its low of 284.25 (February 25 London fix) into the 330's, and that's certainly a positive sign for the pro-inflation forces. But my own suspicion (I'm not totally convinced, but this is a suspicion) is that gold is not rising on inflation fears. Instead, I think that gold is merely adjusting to a much weaker dollar.

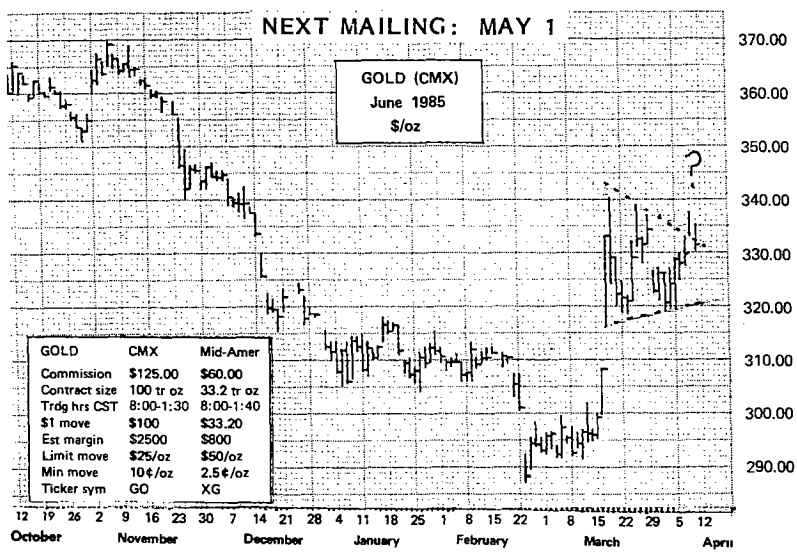
I don't want to be a wise guy or a crystal-baller, so it might be better to turn to this Dunn & Hargitt daily chart of the June gold contract. Here we see the gapping gold action down to 287, the bottoming action, and then the mid-March gapping-explosion to 340. Since then a little triangle has formed, and the "expected" action would be a breakout above the triangle to around the 350-360 level.

On April 11, June gold popped above the upper trendline of the triangle, and we'll just let the yellow metal tell its story from here. I opined in previous Letters that I thought the real "play" against the topped-out dollar would be the foreign currencies rather than gold or silver. So far, that's been correct. On April 11 the British pound, for instance, roared to a new high above 1.24. Since late-February the pound has risen an incredible 22% against the dollar. Remember, back in February when the smart boys were talking about a pound that would be worth a buck?

One technical plus for gold that I want to mention is my gold-to-common stock ratio. I run this ratio on both a 3-week and an 8-week moving average. The 3-week MA has now pushed above the 8-week MA. This is my major signal for a switch in relative strength from common stocks to gold. Major gold rises have occurred only when the ratio is in this mode.

My old friend, Jon Strebler, is an excellent technician and a long-time precious metal watcher. He's a bull on gold now, and if you'd like to see his latest analysis write to Strebler, Delfin Commodity Investors, 110 Holly Ave., Imperial Beach, CA 92032. Send $5.

NEXT MAILING: MAY 1



LATE NOTES: On April 12 the PTI hit another new recovery high of 1720. But the Dow continues to lag. The divergence (see page 2 chart) is dramatic now. The market will hold together as long as the PTI continues to climb. But there will be trouble if the PTI turns down following this kind of action. ... Meanwhile, the currencies are outperforming gold. And the dollar's weakness is stirring up some of the big exporting stocks such as DuPont and IBM.